Economic Outlook for the US and Indiana

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December 17, 2012

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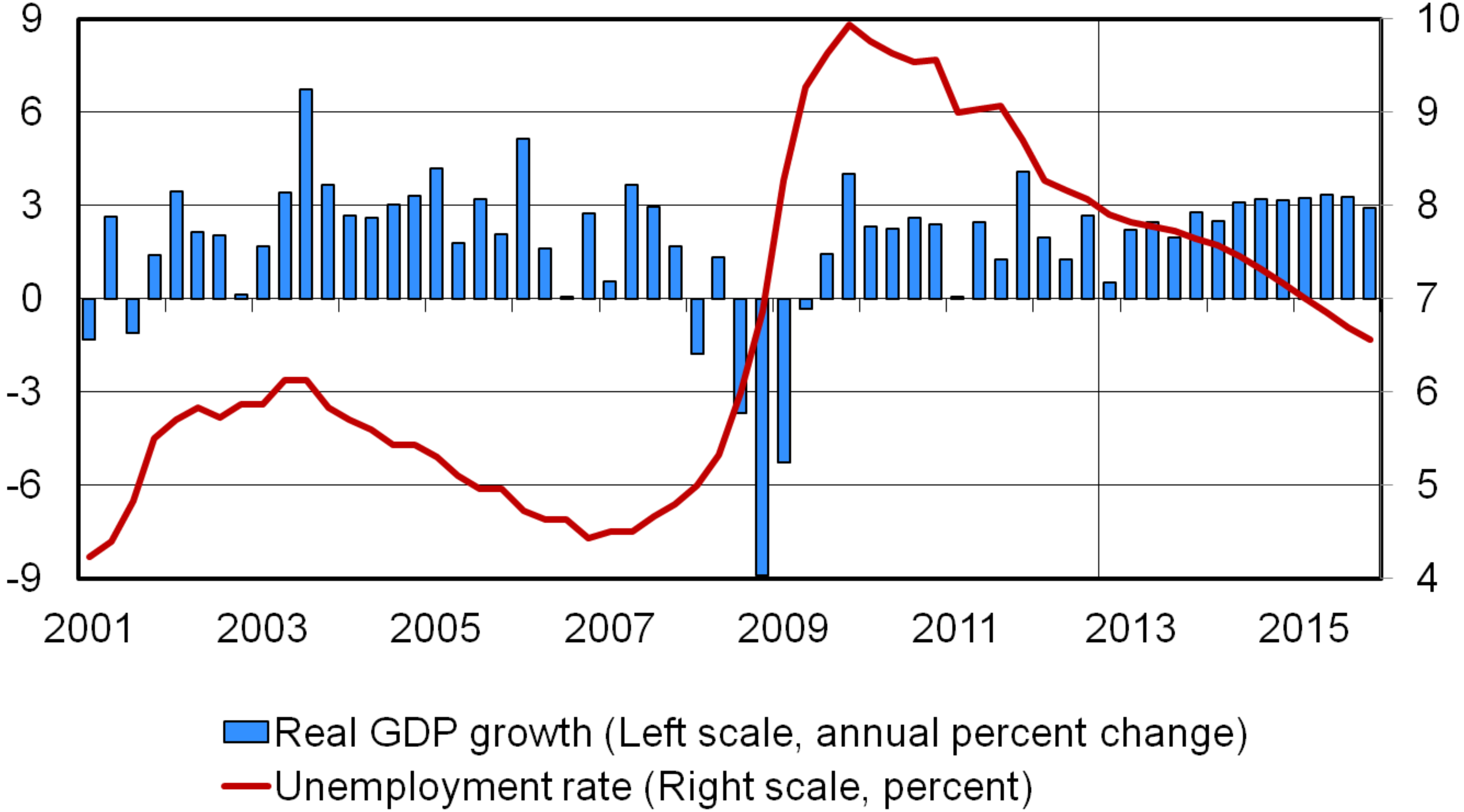
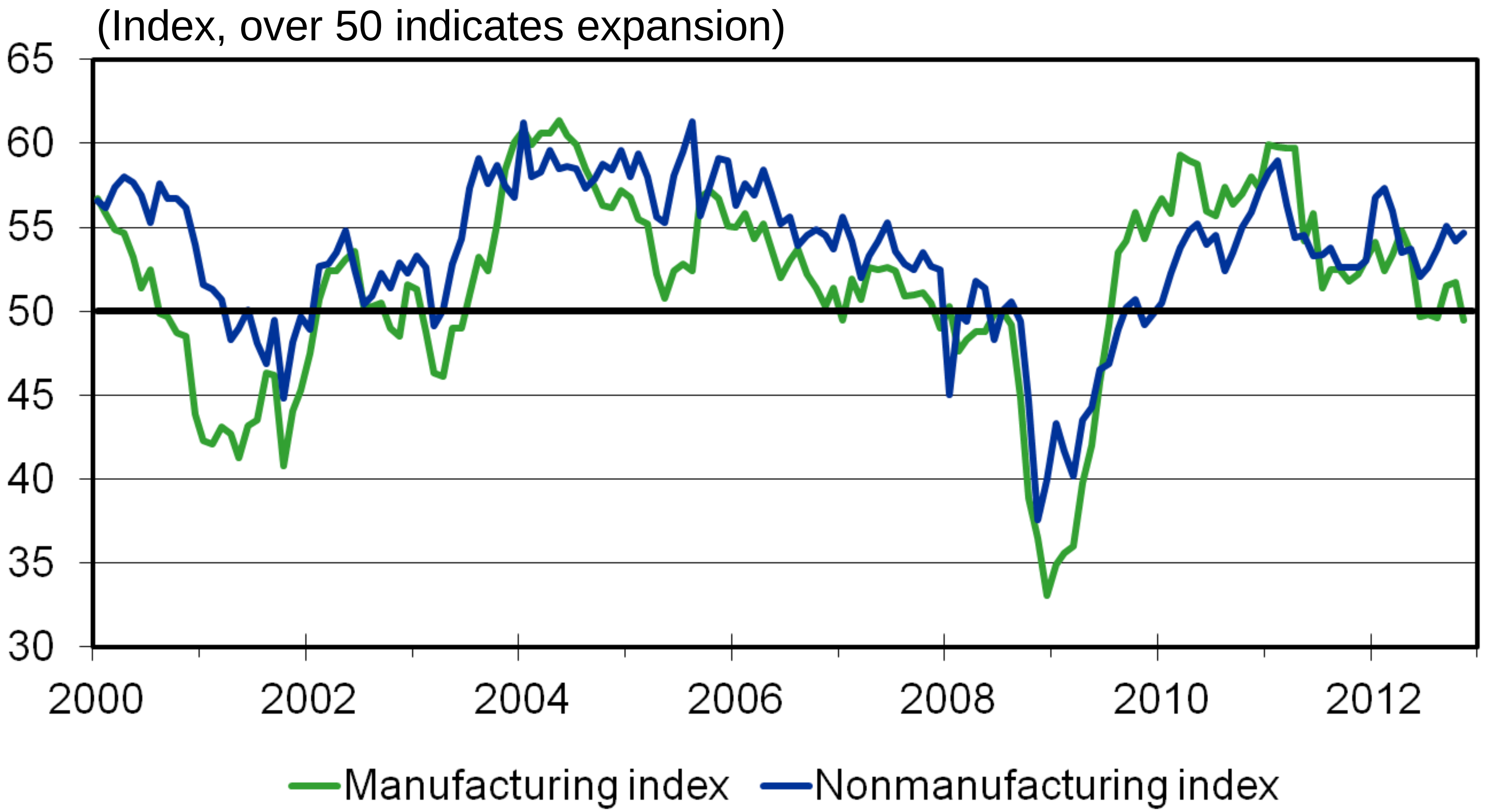
Modest US economic growth continues

- The expansion has weak momentum, but is moving forward.
- Exports and business capital spending are restrained by global economic headwinds and domestic policy uncertainty.
- Housing and vehicle markets are rebounding, supporting growth.
- Consumers will cautiously increase their spending in response to moderate gains in employment, income, and net worth.
- We assume a last-minute agreement to avoid the fiscal cliff, resulting in substantial tax increases on upper-income earners and modest spending cuts.
- The probability of a return to recession in 2013 remains at 20%.

Real GDP growth and the unemployment rate

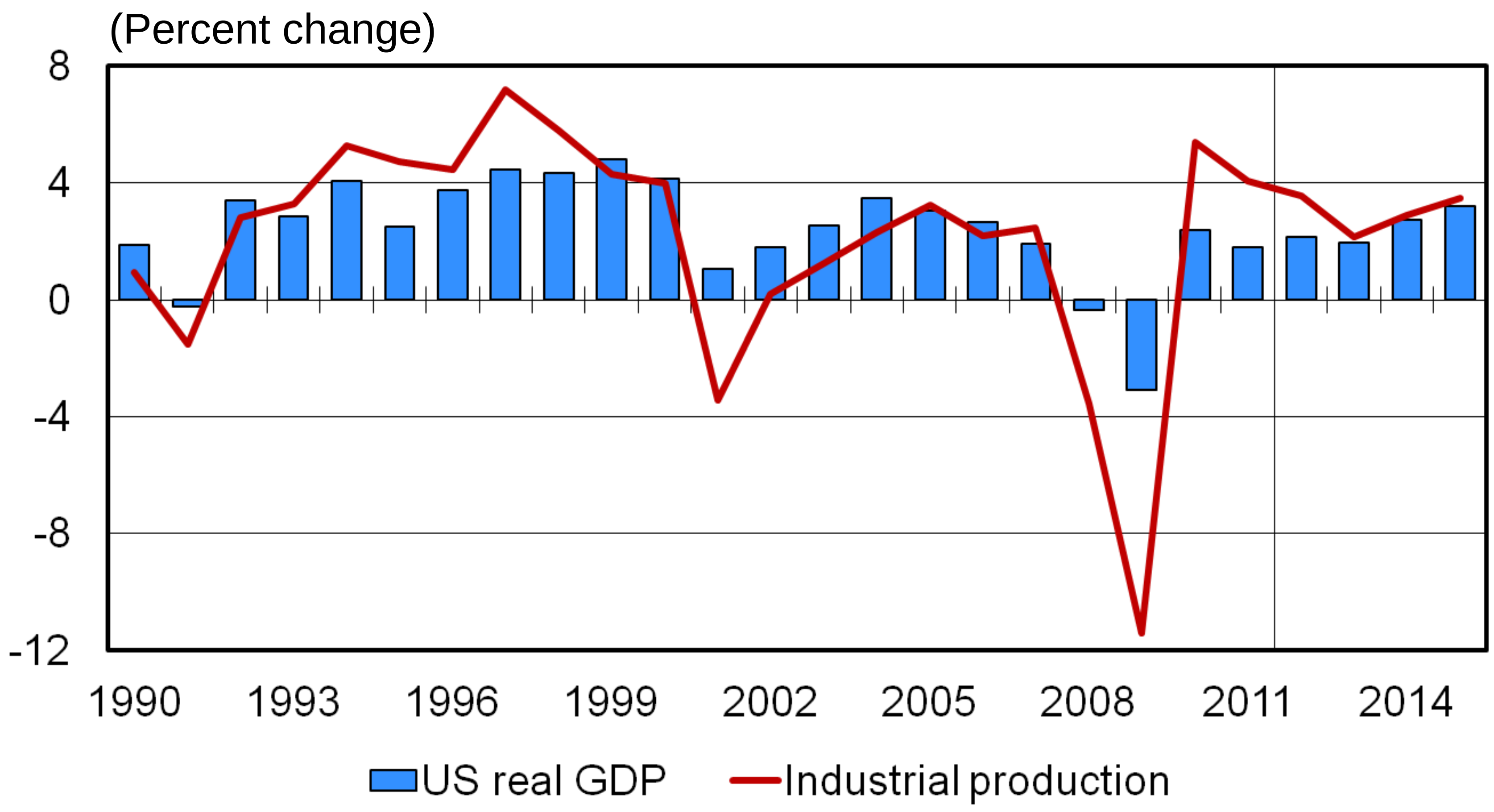


The Institute for Supply Management's indexes signal a pause in manufacturing and sustained services growth



Source: Institute for Supply Management (ISM)

A subdued recovery from a severe recession: Real GDP and industrial production growth



US economic growth by sector

(Percent change)

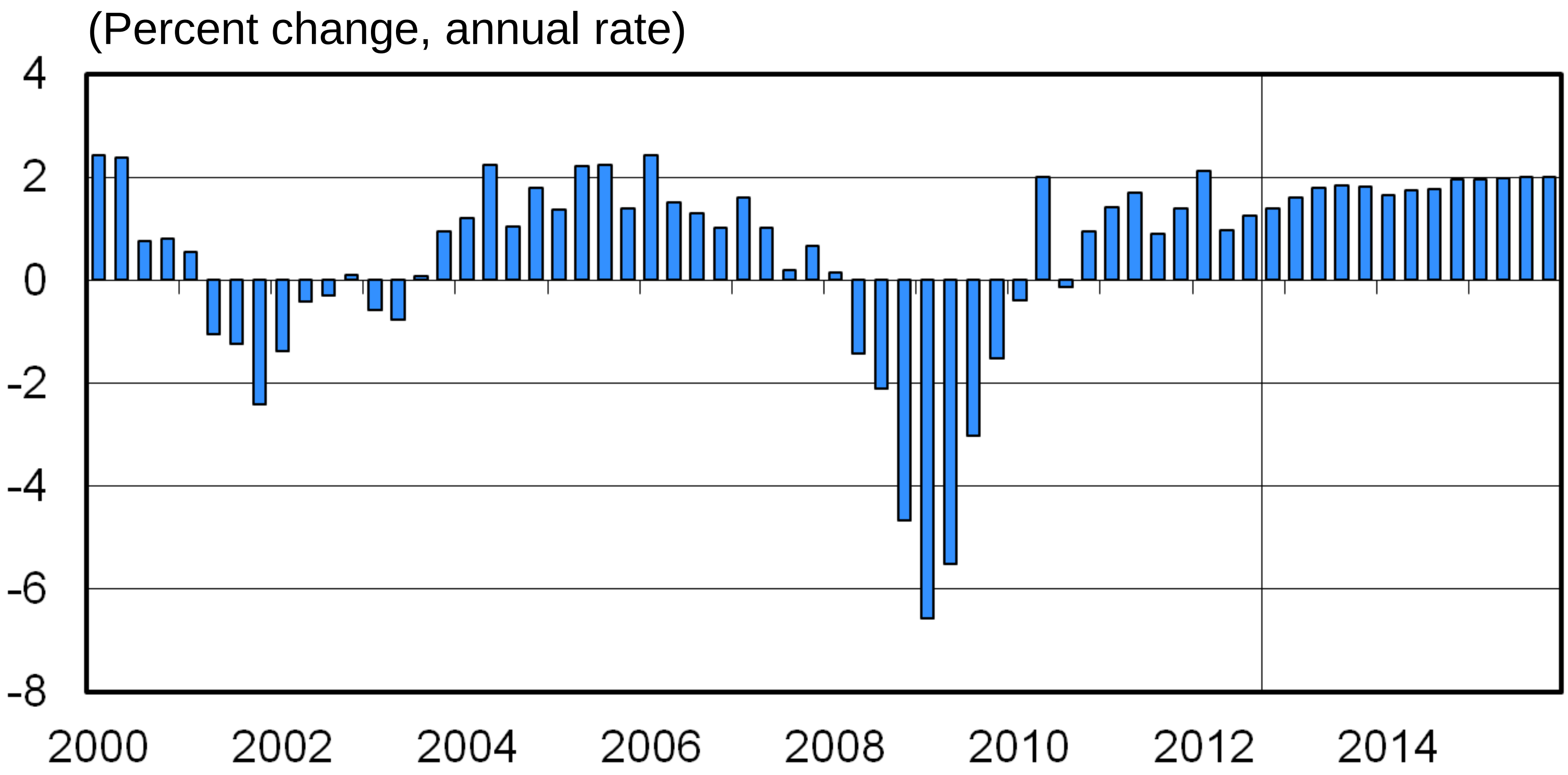
	2011	2012	2013	2014
Real GDP	1.8	2.2	1.9	2.7
Consumption	2.5	1.8	2.2	2.6
Residential investment	-1.4	12.4	15.1	18.8
Business fixed investment	8.6	7.3	3.8	7.8
Federal government	-2.8	-1.6	-2.9	-3.2
State & local government	-3.4	-1.4	-0.2	0.3
Exports	6.7	3.7	3.6	4.4
Imports	4.8	2.9	3.1	5.3

Other key US indicators

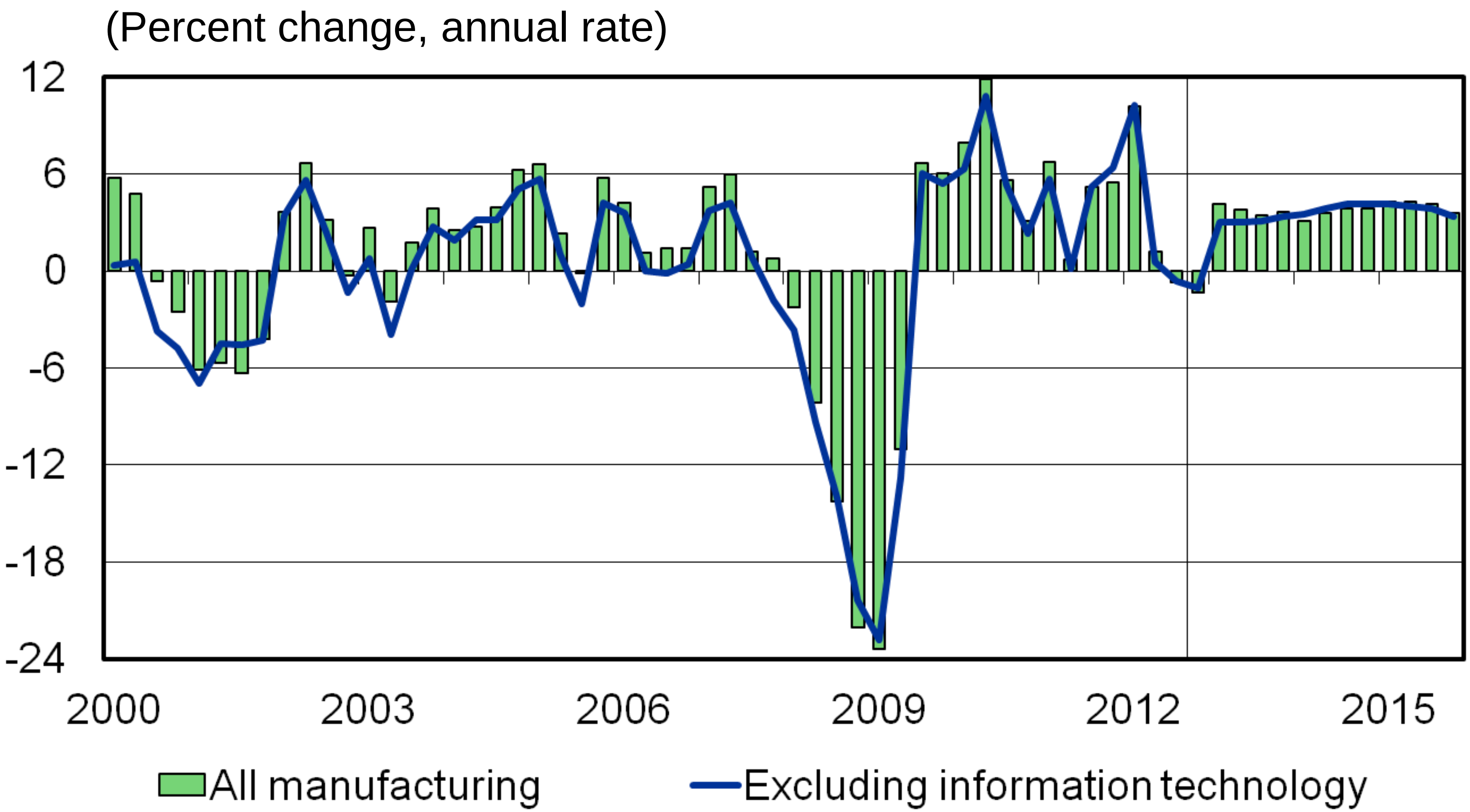
(Percent change unless noted)

	2011	2012	2013	2014
Industrial production	4.1	3.6	2.2	2.9
Payroll employment	1.2	1.4	1.6	1.8
Light-vehicle sales (Millions)	12.7	14.4	15.1	15.7
Housing starts (Millions)	0.61	0.78	0.98	1.29
Consumer Price Index	3.1	2.1	1.4	1.8
Core CPI	1.7	2.1	1.9	2.0
Refiners' acquisition oil price ($/barrel)	102	101	89	85
Federal funds rate (%)	0.1	0.1	0.2	0.2
10-year Treasury yield (%)	2.8	1.8	2.0	2.7

US employment will gradually recover, regaining its January 2008 peak in mid-2014



Manufacturing production growth will resume in 2013



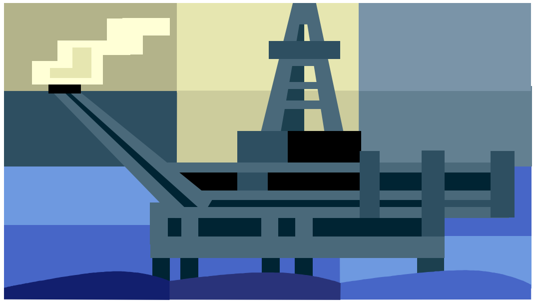
US industrial production growth

(Percent change)

	2011	2012	2013	2014
All manufacturing	4.8	4.2	2.1	3.5
Motor vehicles & parts	11.8	18.5	6.0	4.7
Computers & electronics	7.9	3.7	3.3	8.7
Electrical equip. & appliances	3.2	4.7	2.3	4.0
Machinery	0.1	-2.3	-0.6	0.8
Textiles	-2.4	-3.6	-5.9	-3.9
Furniture	5.0	3.1	0.2	4.6
Chemicals	0.5	0.1	0.7	2.5

Increasing crude oil supplies will restrain prices

- Oil prices are currently supported by anxiety over supply availability.
- Market fundamentals will reassert themselves as global economic growth remains subdued in the year ahead and spare capacity rises.
- Rising production in the United States, Canada, Iraq, Kazakhstan, and Brazil will lead to oil price declines in 2013-15.
- The spread between Brent and WTI prices will narrow significantly as pipeline construction alleviates congestion in the Mid-Continent.
- Security challenges in the Middle East and Africa, including the unresolved Iranian nuclear issue, pose upside risks to the price forecast.



Forces affecting consumer spending

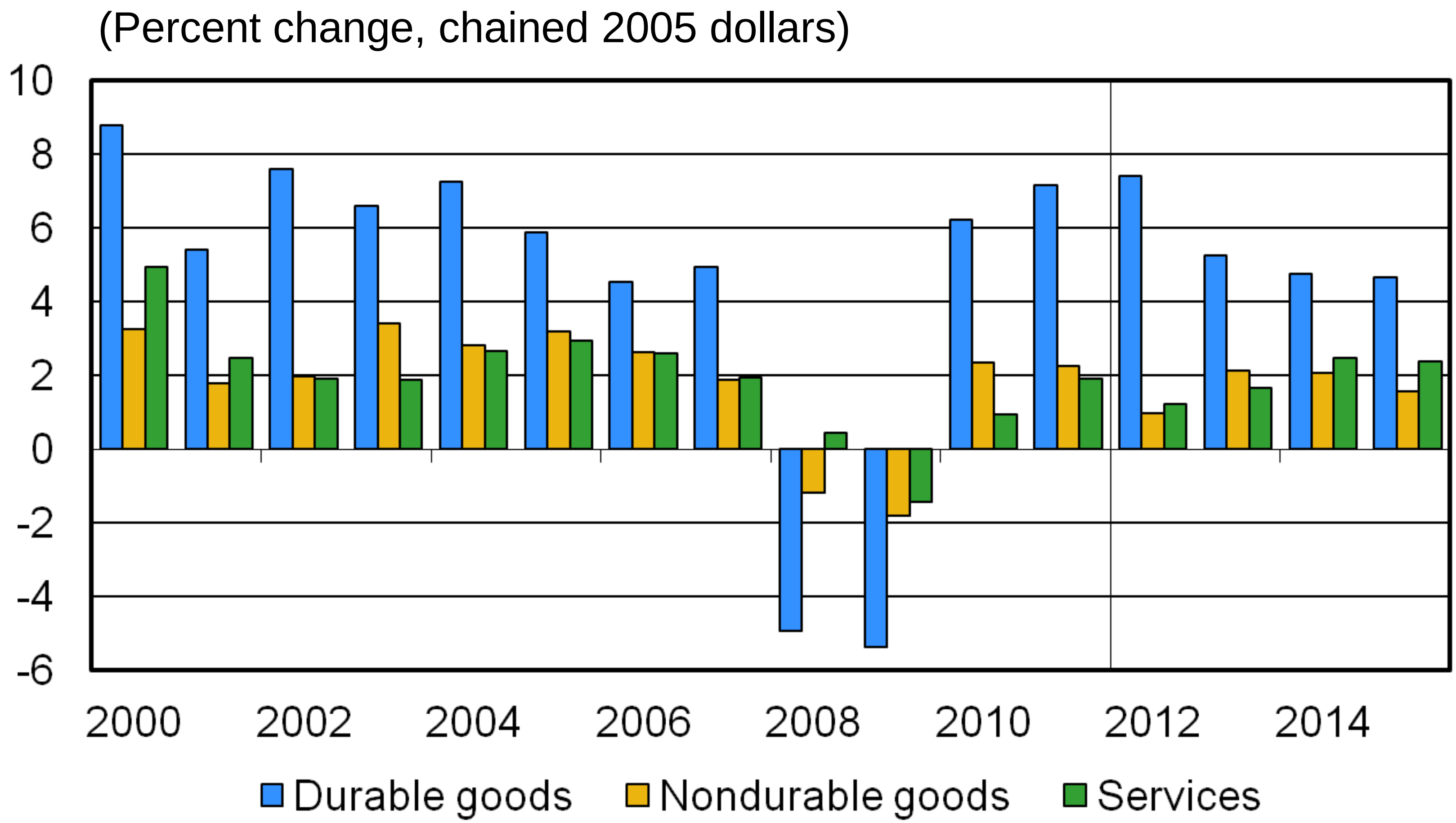
<u>Positive forces</u>

- Pent-up demand
- Rising employment
- Modest income growth
- Easing credit conditions

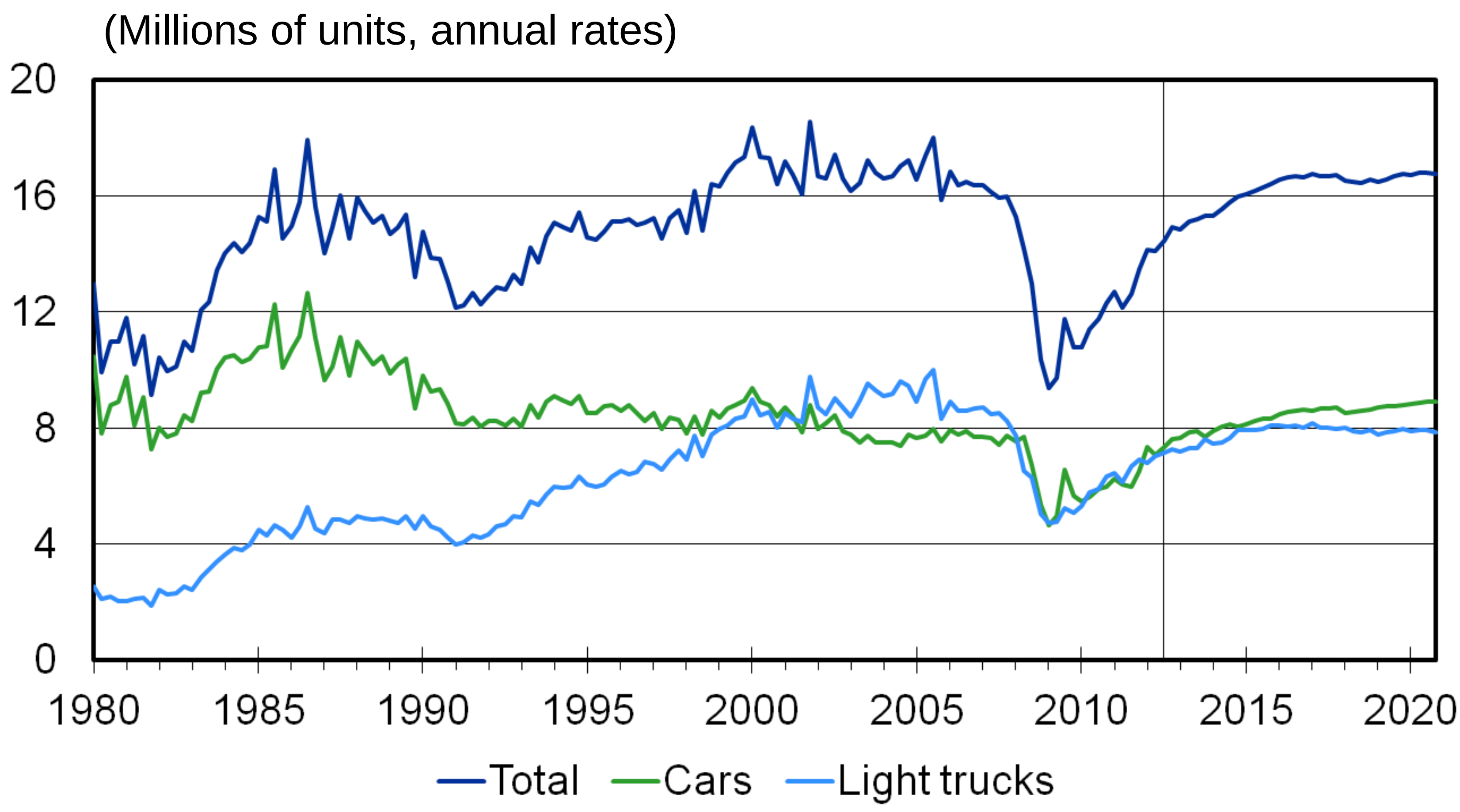
<u>Negative forces</u>

- High unemployment rate
- Weak wage gains
- Lost housing wealth
- Fiscal tightening ahead

Pent-up demand for durable goods is driving growth in consumer spending



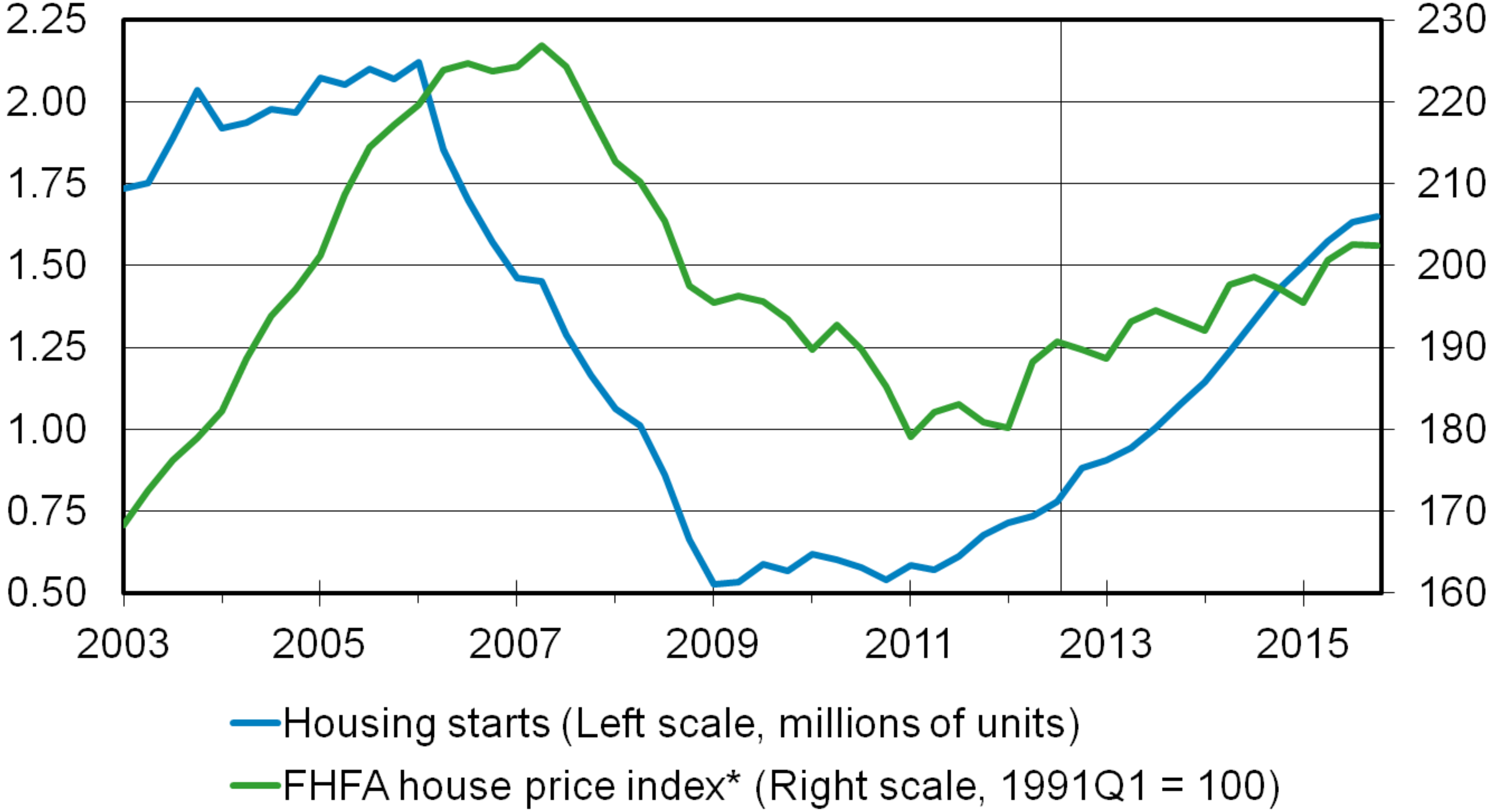
US light-vehicle sales will continue to recover



Housing markets recover from depressed levels

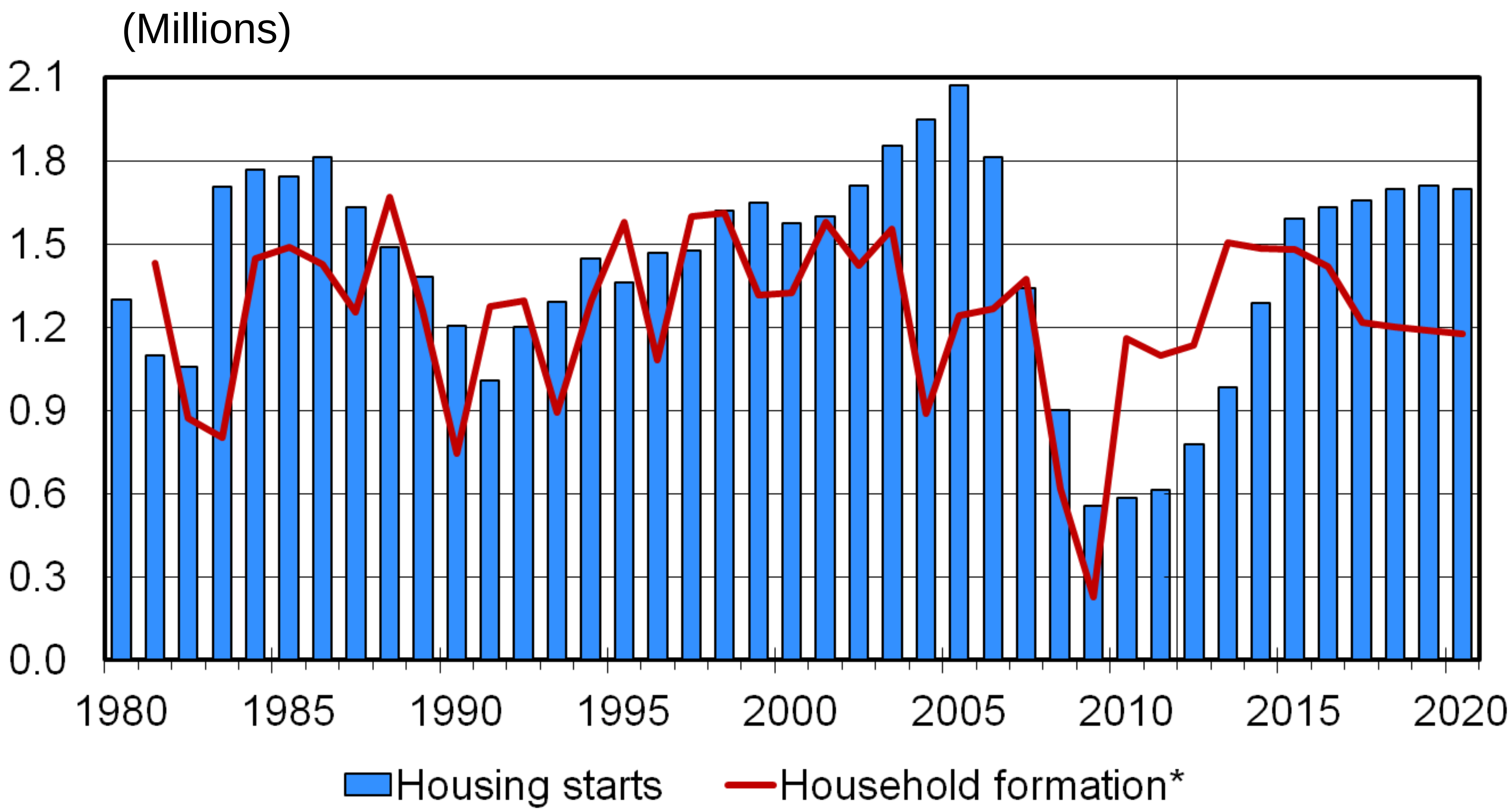
- Job growth is sparking a recovery in household formation
- Record housing affordability is boosting demand
- But credit standards remain relatively strict
- Multifamily housing has led the recovery
- Single-family home sales and prices are turning up
- Baby boomers are downsizing

Housing starts and home prices begin to recover



* Purchase-only index

A rebound in household formation will support substantial increases in housing starts



* The introduction of new population controls led to a discontinuity in household data in 2011. This chart shows the previous estimate of household formation for 2011.

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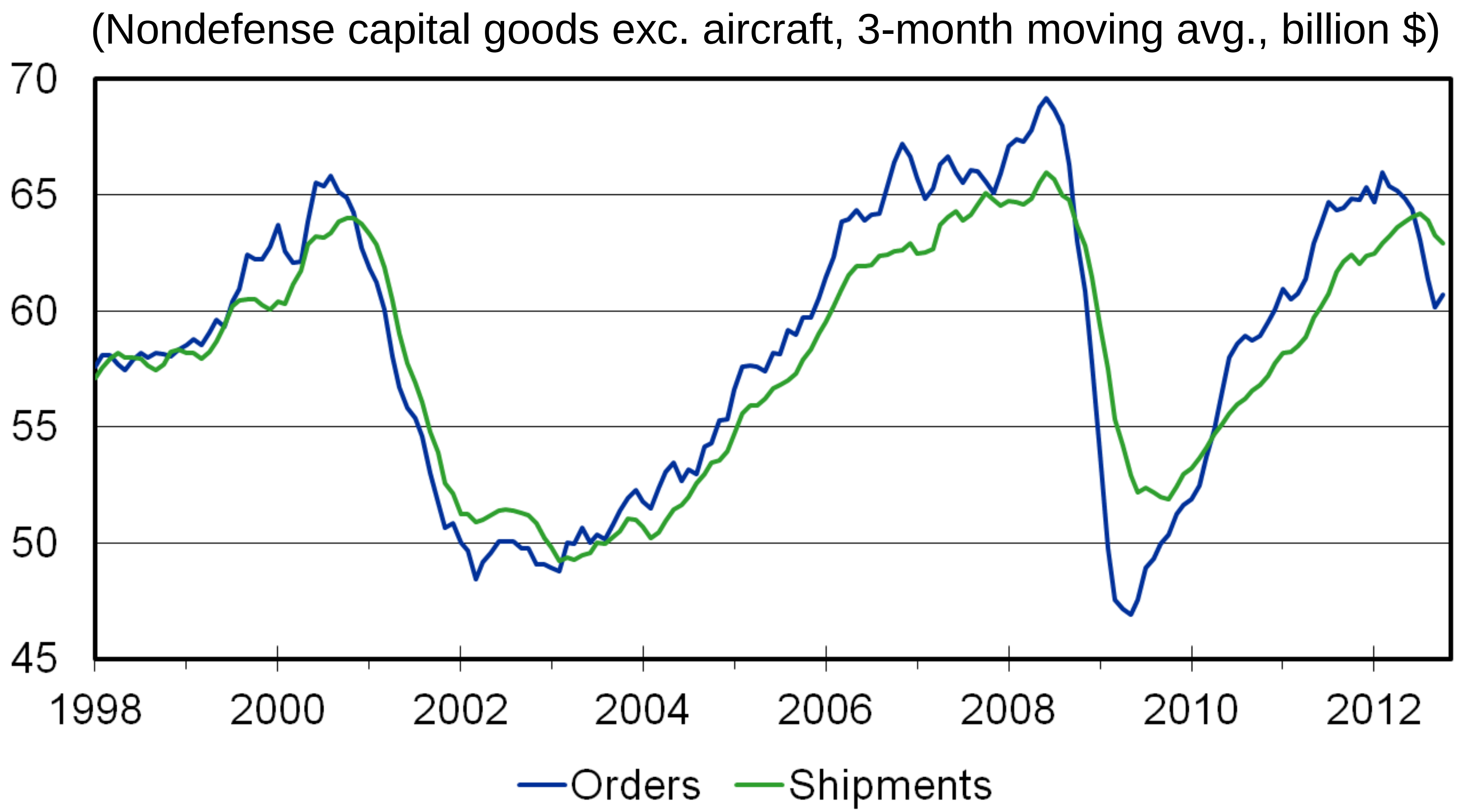
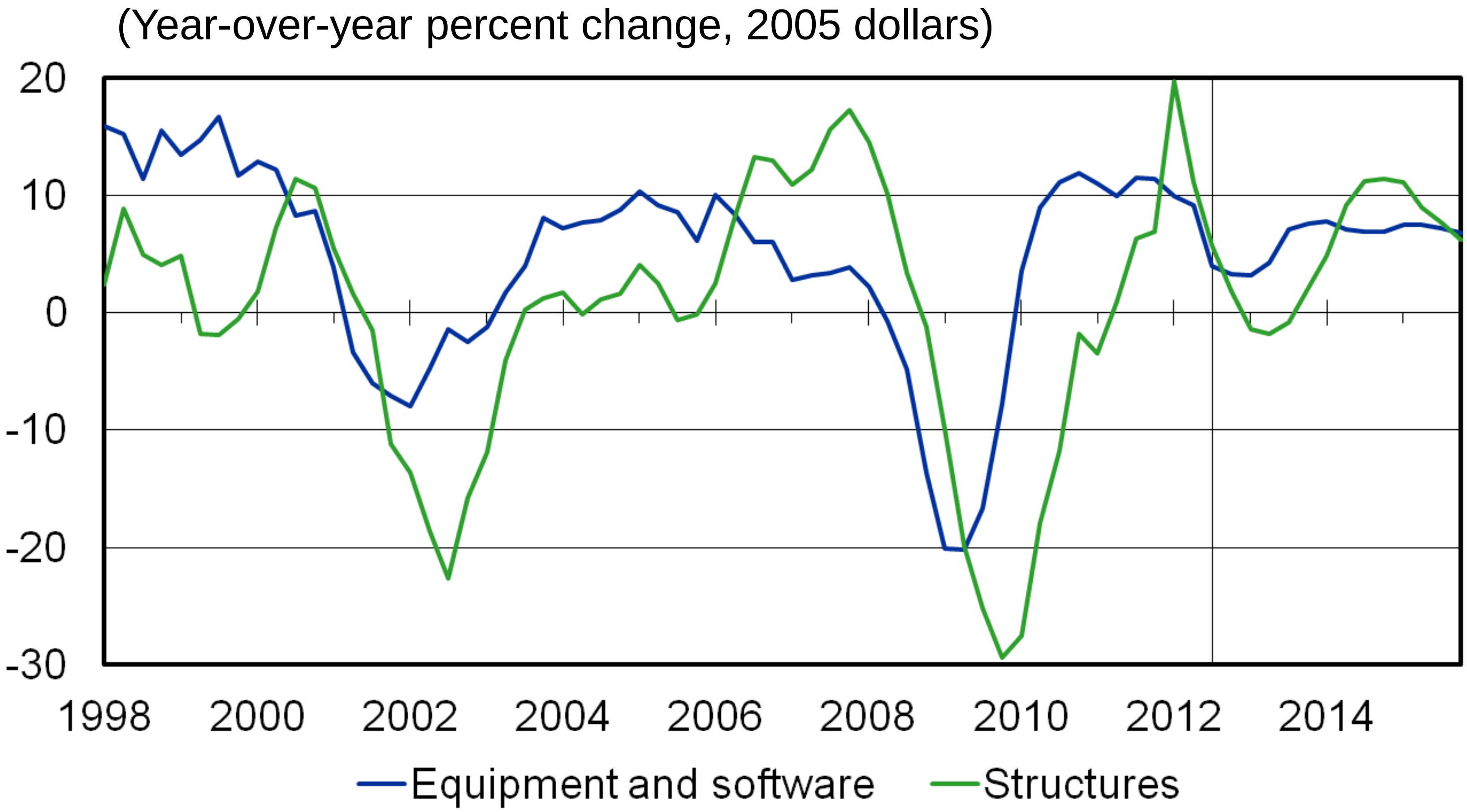
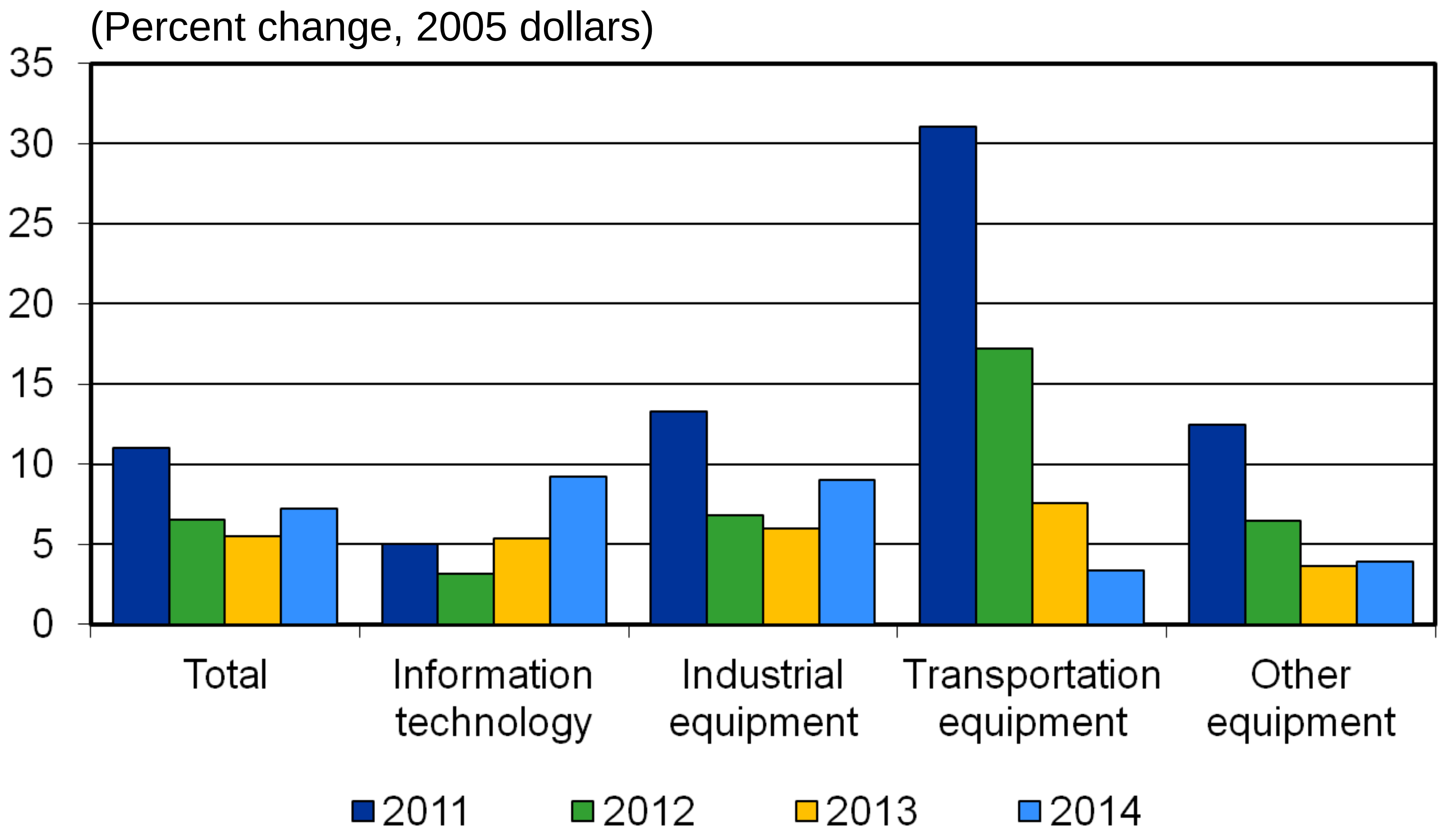
New orders for business equipment have decreased



Business fixed investment decelerates



Growth in real business equipment and software investment by category



Dateline: The "fiscal cliff" is near

- 1 January 2013: Spending sequester kicks in; Bush tax cuts, payroll tax cut, and emergency unemployment benefits expire
- *A fiscal contraction of at least 3% of GDP will hit if nothing is done*

- 3 January 2013: 113th US Congress convenes
- 20 January 2013: Presidential inauguration
- 31 March 2013: Continuing resolution authorizing FY 2013 spending expires
- First-quarter 2013: Federal debt ceiling will need to be raised

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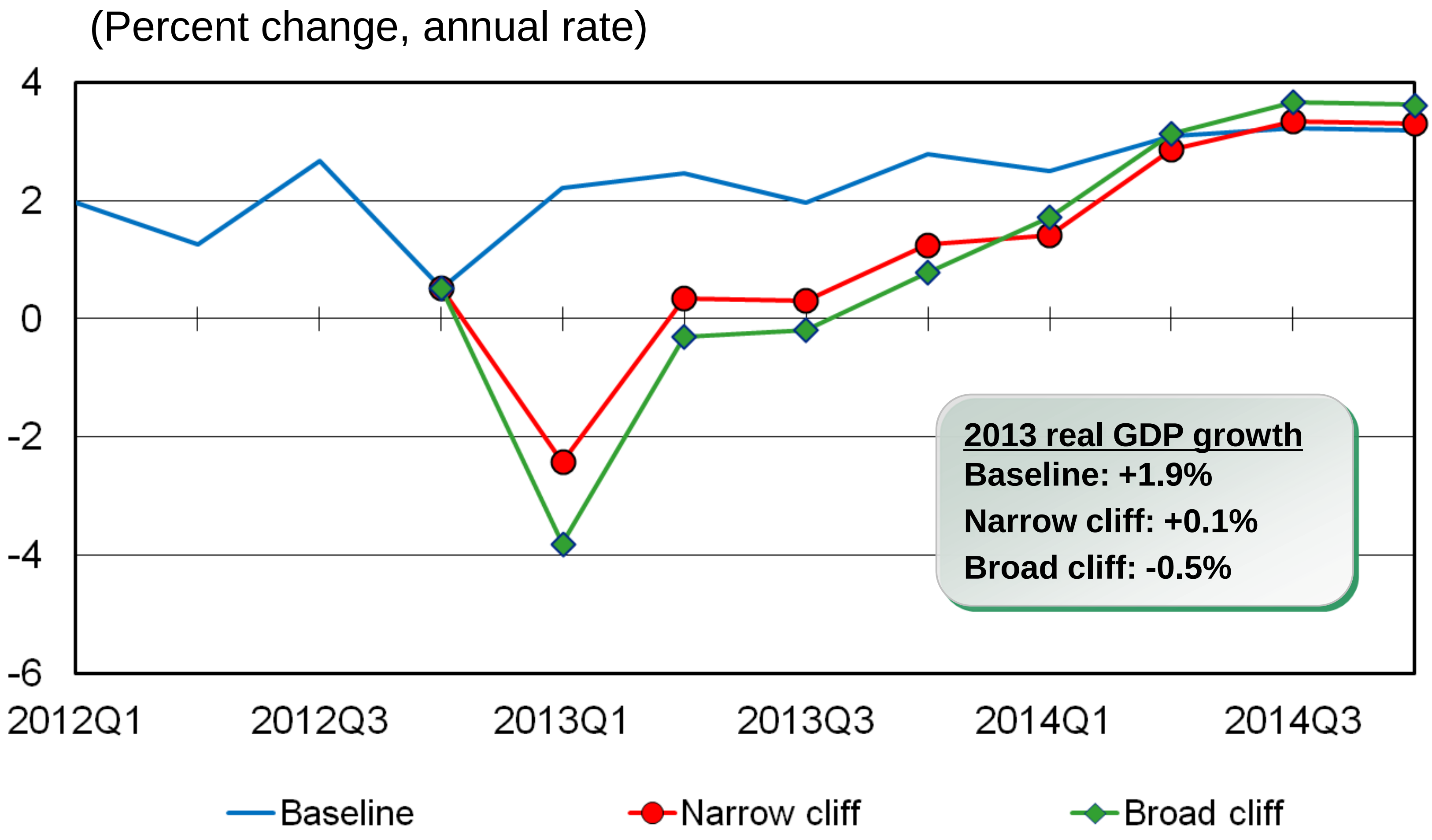
Dimensions of the 2013 “fiscal cliff”

All figures are calendar-year estimates	Billion $	Percent of GDP
Possible:		
Bush tax cut expiry	192	1.2
Payroll tax cuts expiry	113	0.7
Sequester spending cuts	72	0.4
Emergency UI benefits expiry	45	0.3
Depreciation incentives expiry	66	0.4
Total—Narrow cliff	**488**	**3.0**
Possible but highly unlikely:		
Alternative Minimum Tax fix not extended	115	0.7
Doc fix (to Medicare cuts) not extended	13	0.1
Total—Broad cliff	**616**	**3.8**

Source: IHS calculations based on CBO data

Real GDP impacts of going off the “fiscal cliff”



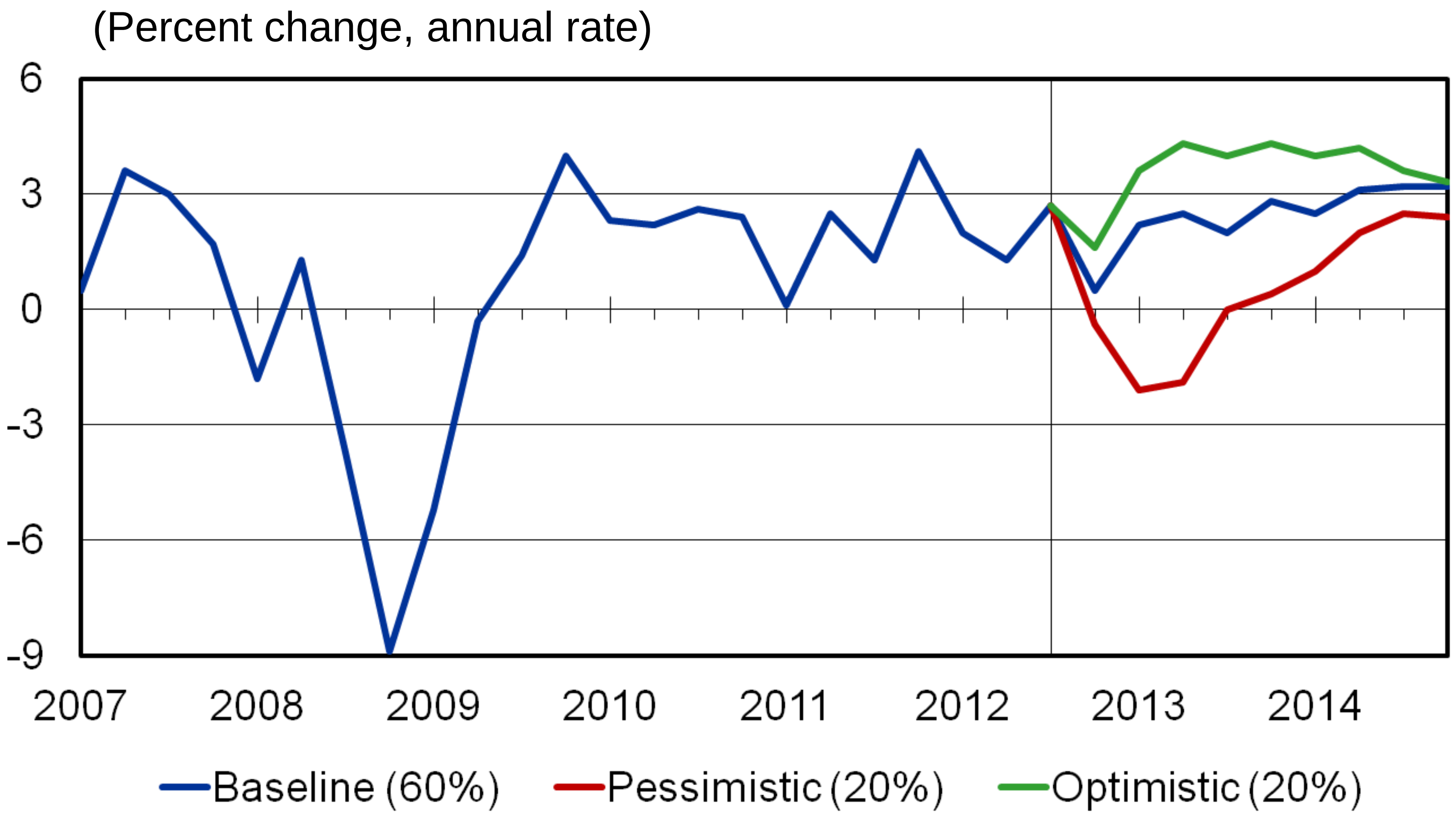
Fiscal policy assumptions: Stepping back from the cliff

- An agreement to avert the fiscal cliff is reached in late December or early January.
- Minor restrictions on income tax deductions take effect in 2013.
- Bush tax cuts for high-income earners expire in 2014. Top tax rates on dividends and capital gains rise to from 15% to 20% (plus the 3.8% Medicare surcharge that takes effect in 2013).
- The 2% payroll tax cut and emergency unemployment insurance benefits are extended through 2013 and then phased out over three years.
- Automatic spending cuts are replaced by a combination of these tax increases and modest cuts to entitlements and discretionary spending .

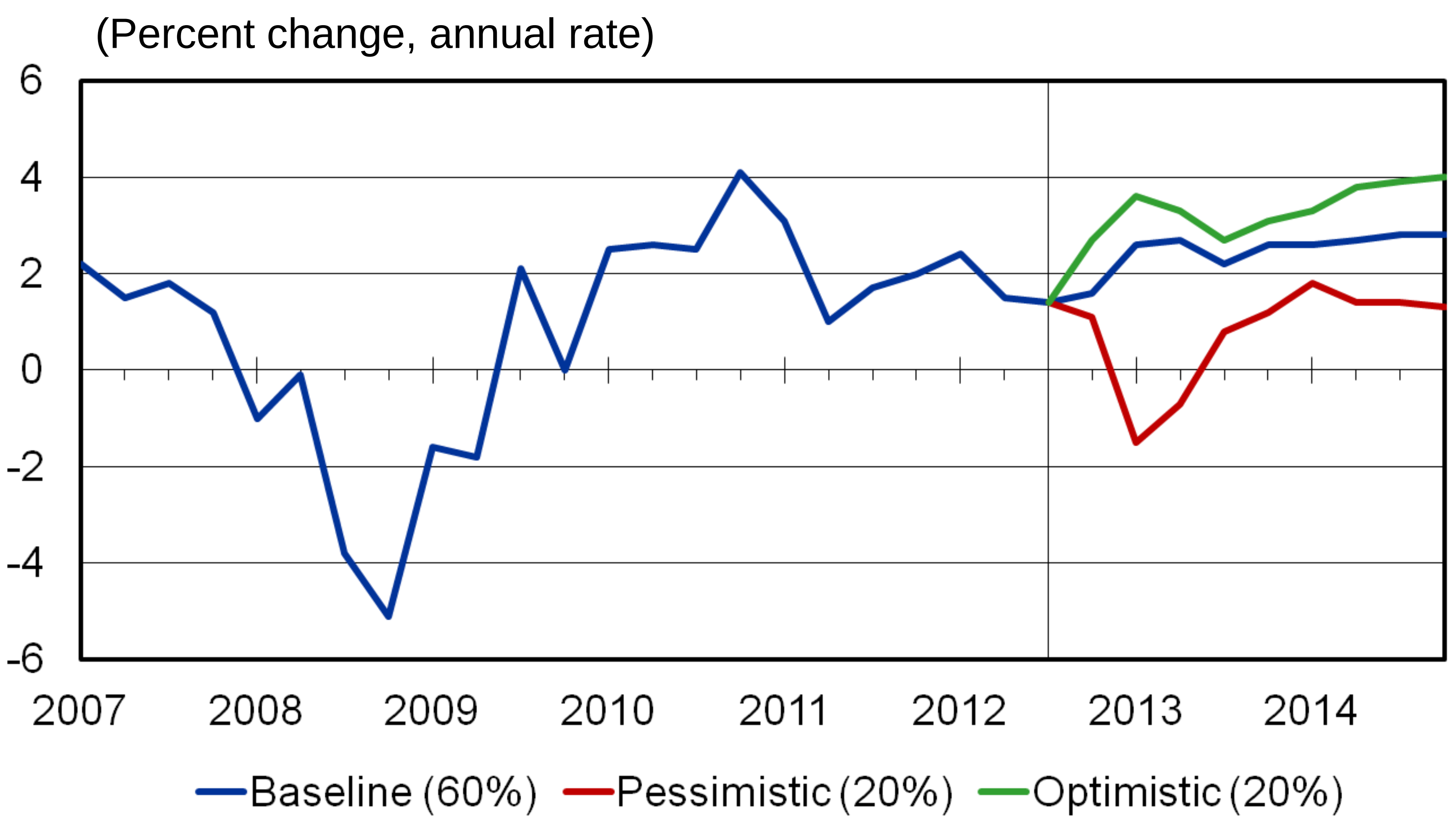
Risks to the US forecast

Scenario	Characteristics
Gridlock in Washington and Europe derail the recovery (Probability = 20%)	• Greek exit from the Eurozone in 2013 leads to financial instability and a more severe recession in Europe • Weaker global economic growth hurts US exports • Partisan brinksmanship briefly pushes the US economy off the fiscal cliff in January, damaging confidence
Recovery reignites (Probability = 20%)	• Confidence revives, leading to more spending and hiring • Housing markets rebound more quickly • Greece remains in Eurozone; the bloc moves toward a banking and fiscal union that helps stabilize markets • Consumer and business confidence quickly revive
Baseline forecast (Probability = 60%)	• Fiscal policy agreement reached soon, with tax increases on upper-income earners and modest spending cuts • Accommodative monetary policies until into 2015 • Housing markets gradually recover over next four years • Greek exit from Eurozone in 2014 with limited damage

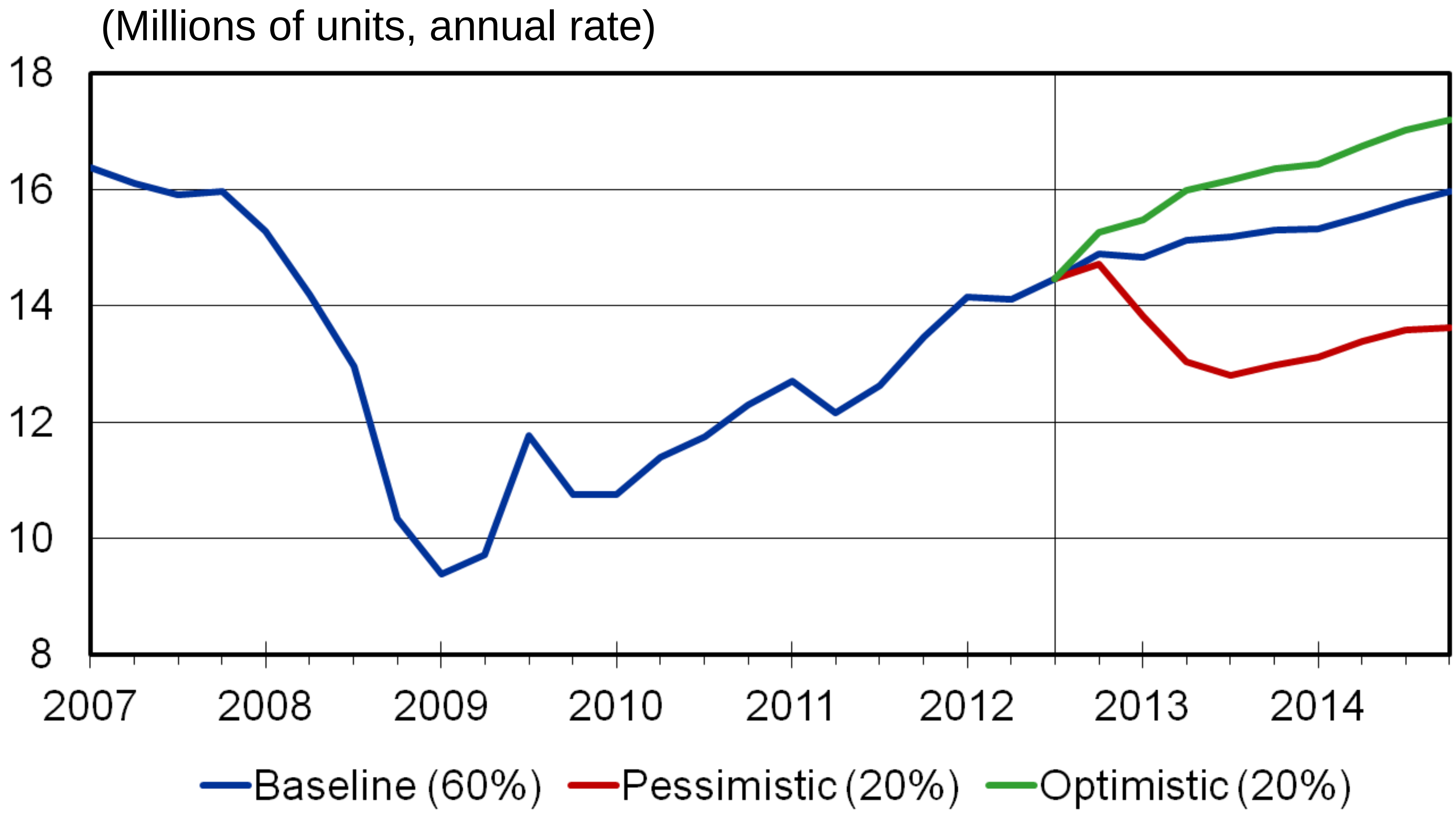
Real GDP growth in alternative scenarios



Real consumer spending growth in alternative scenarios



Light-vehicle sales in alternative scenarios



Bottom line for the US economy

- The expansion will continue, with growth gradually picking up in 2013-14.
- Annual real GDP growth will not top 3% until 2015—when helped by strengthening housing markets and net exports.
- Fiscal tightening is coming, with substantial tax increases for high-income households.
- Upside and downside risks are evenly balanced.
- The major downside risks are:
  - Slipping over the fiscal cliff in January
  - An intensified debt crisis and deepening recession in Europe
  - An oil-price shock resulting from supply disruptions in the Middle East
- On the upside, easing credit conditions and a stronger housing-market recovery could spark faster US growth.

Regional Outlook

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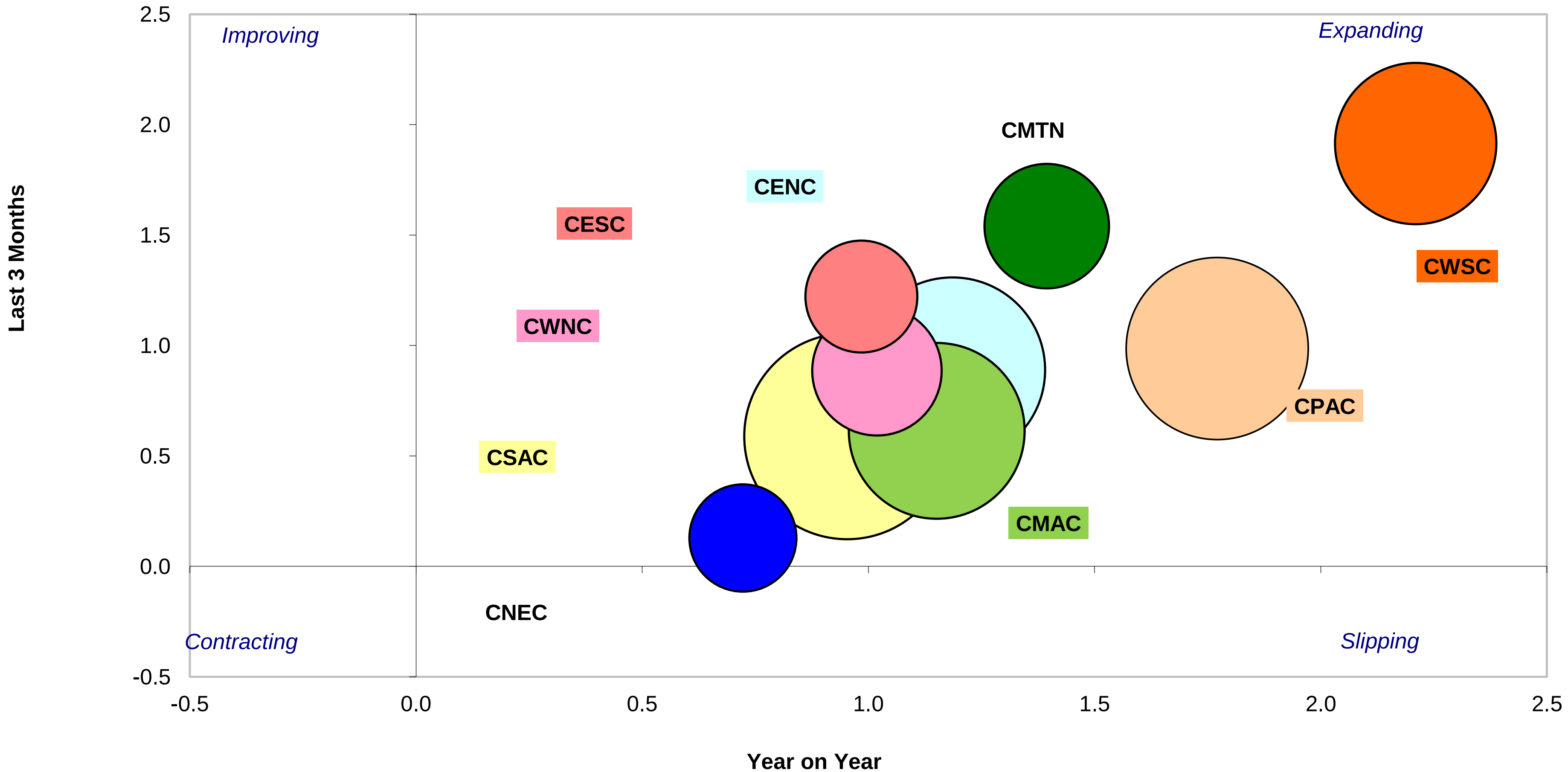
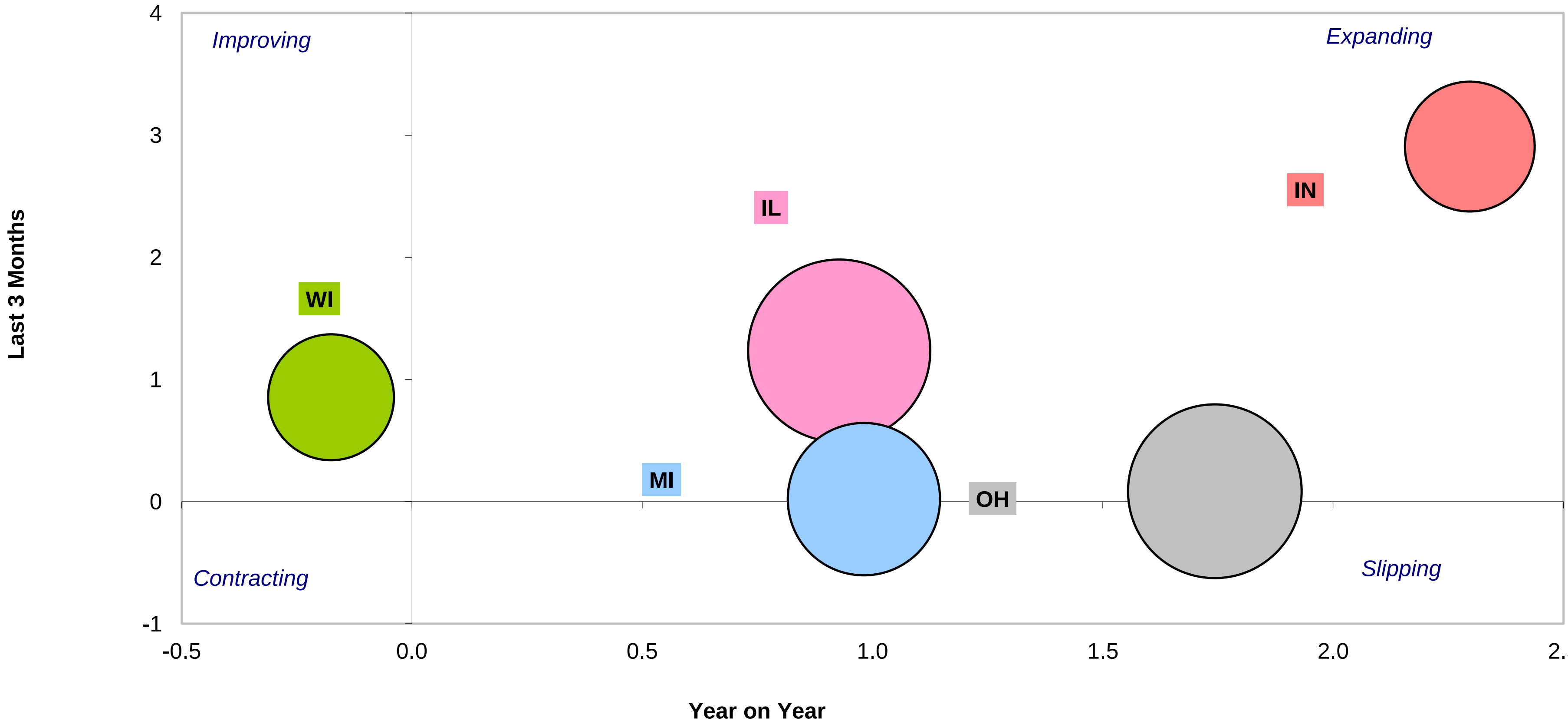
Regional Performance 2012

Employment Momentum in September
(Percent change, annual rate)

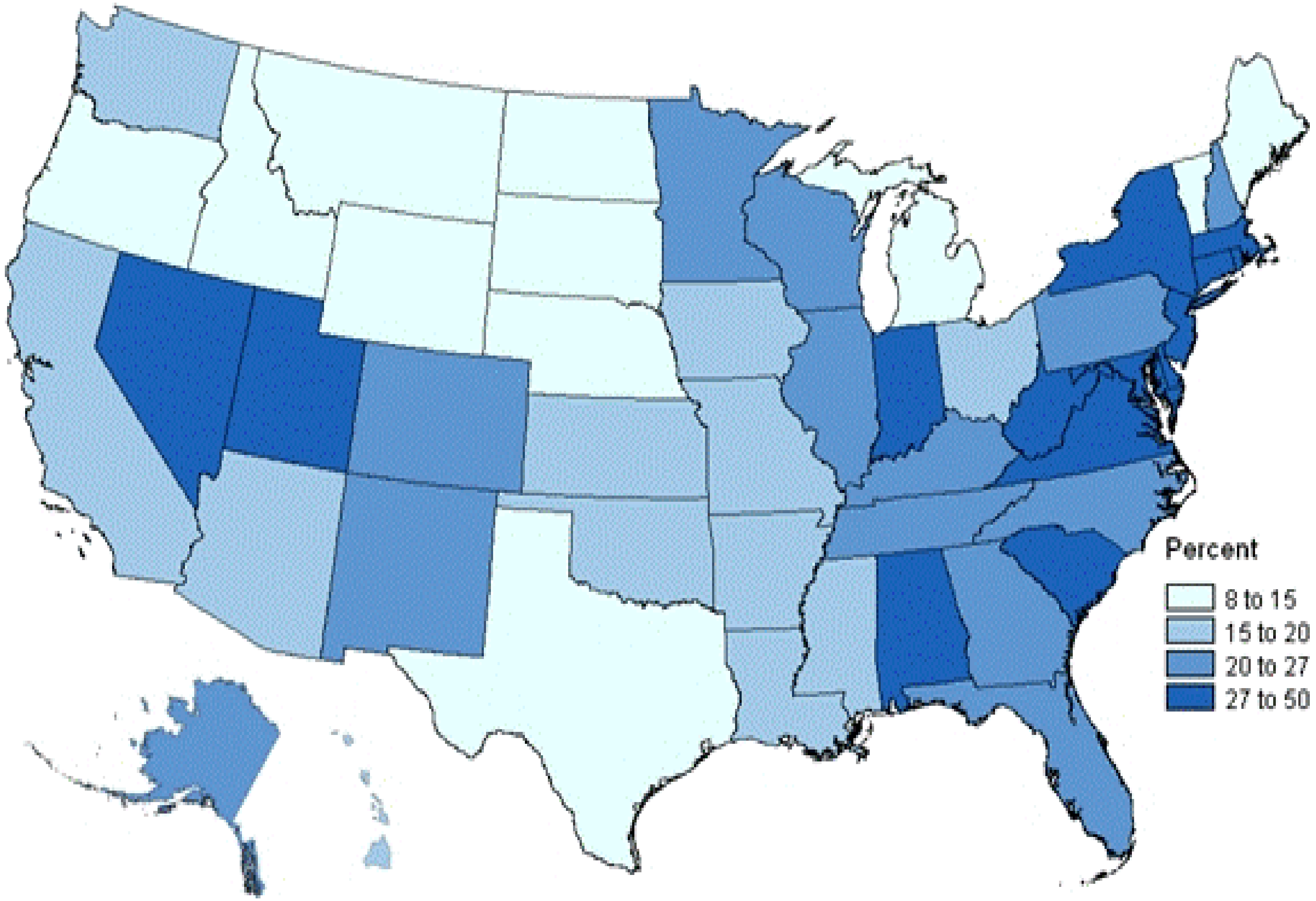


Midwest Performance 2012

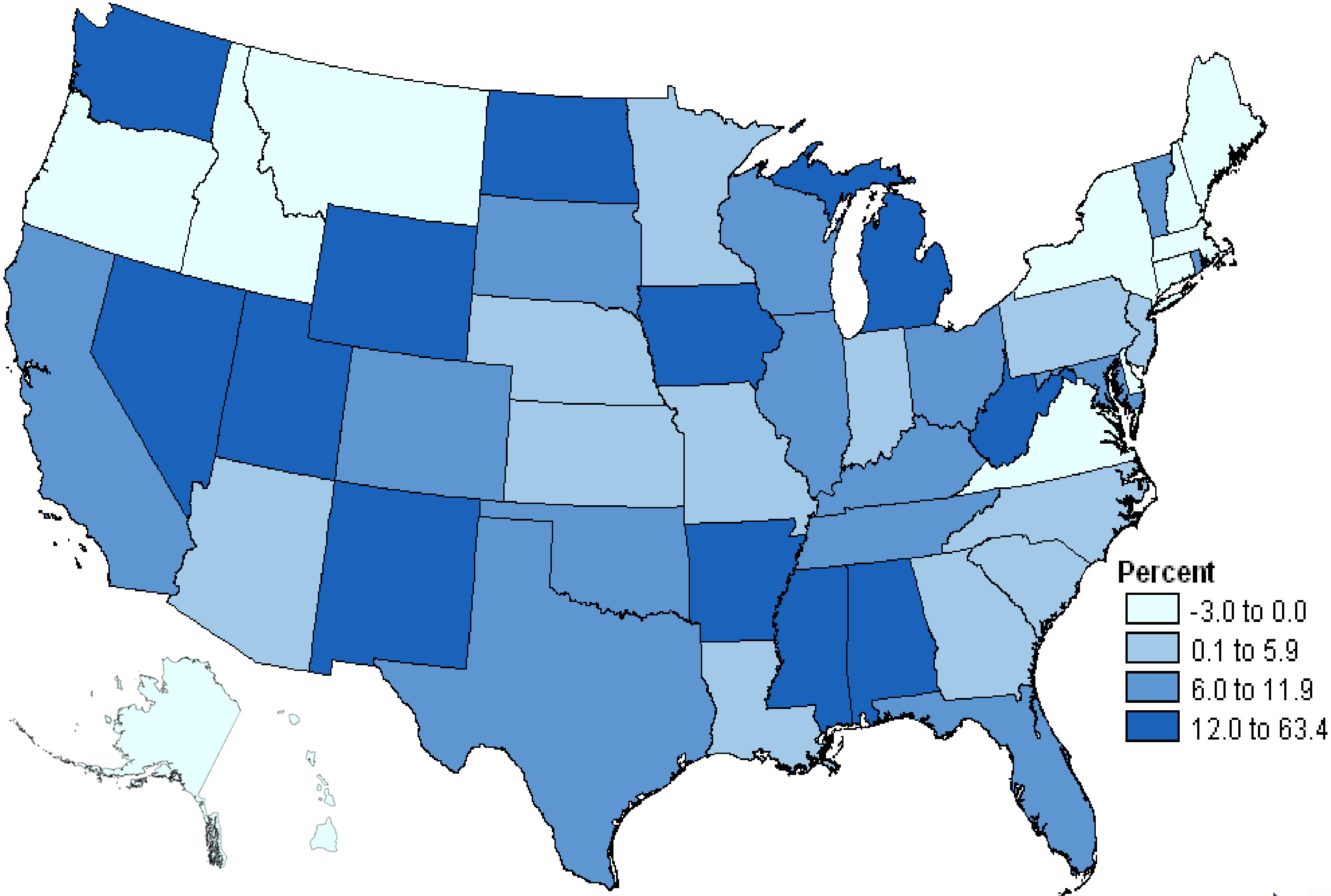
Employment Momentum in September
(Percent change, annual rate)



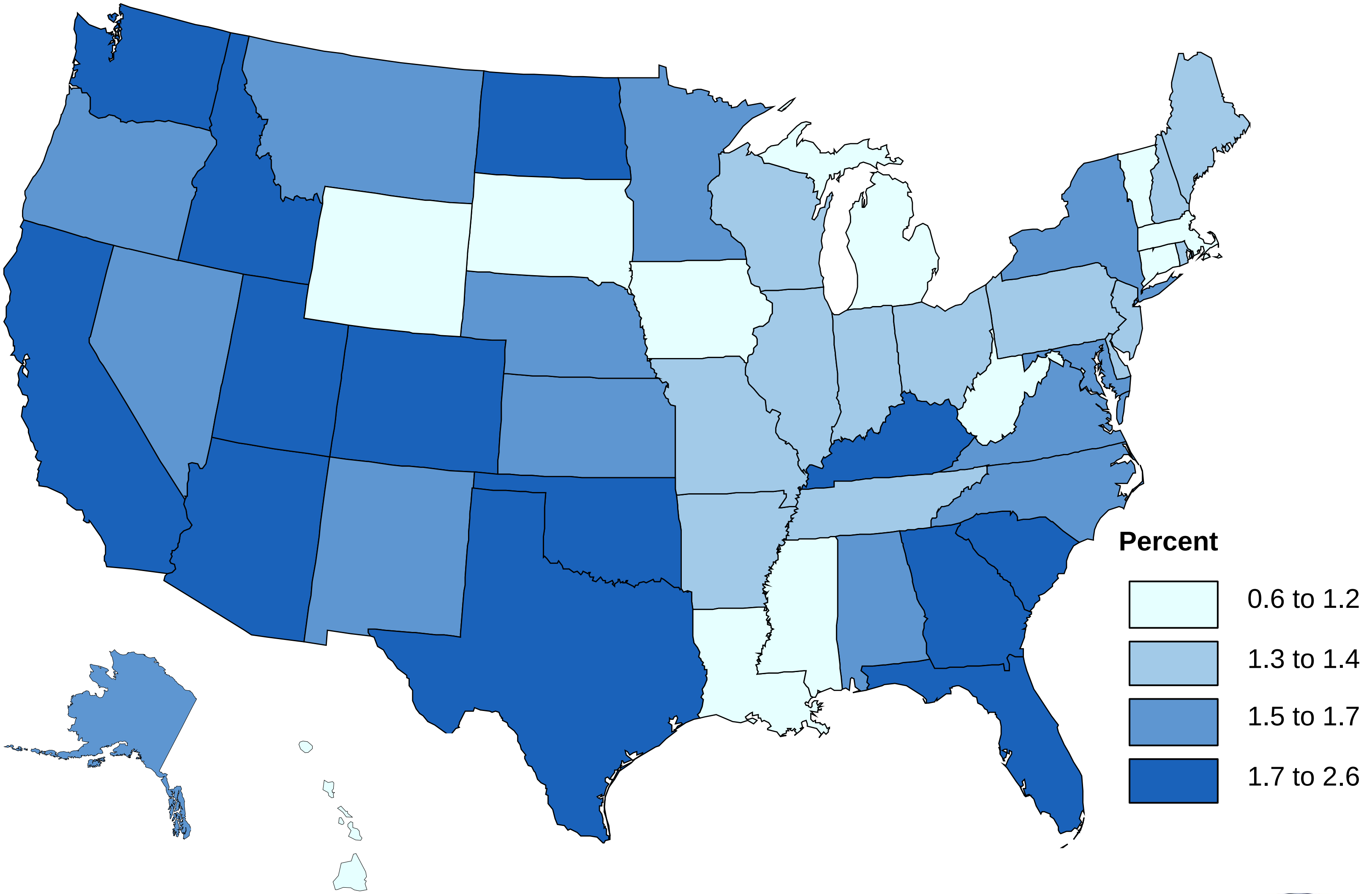
Exports to Europe



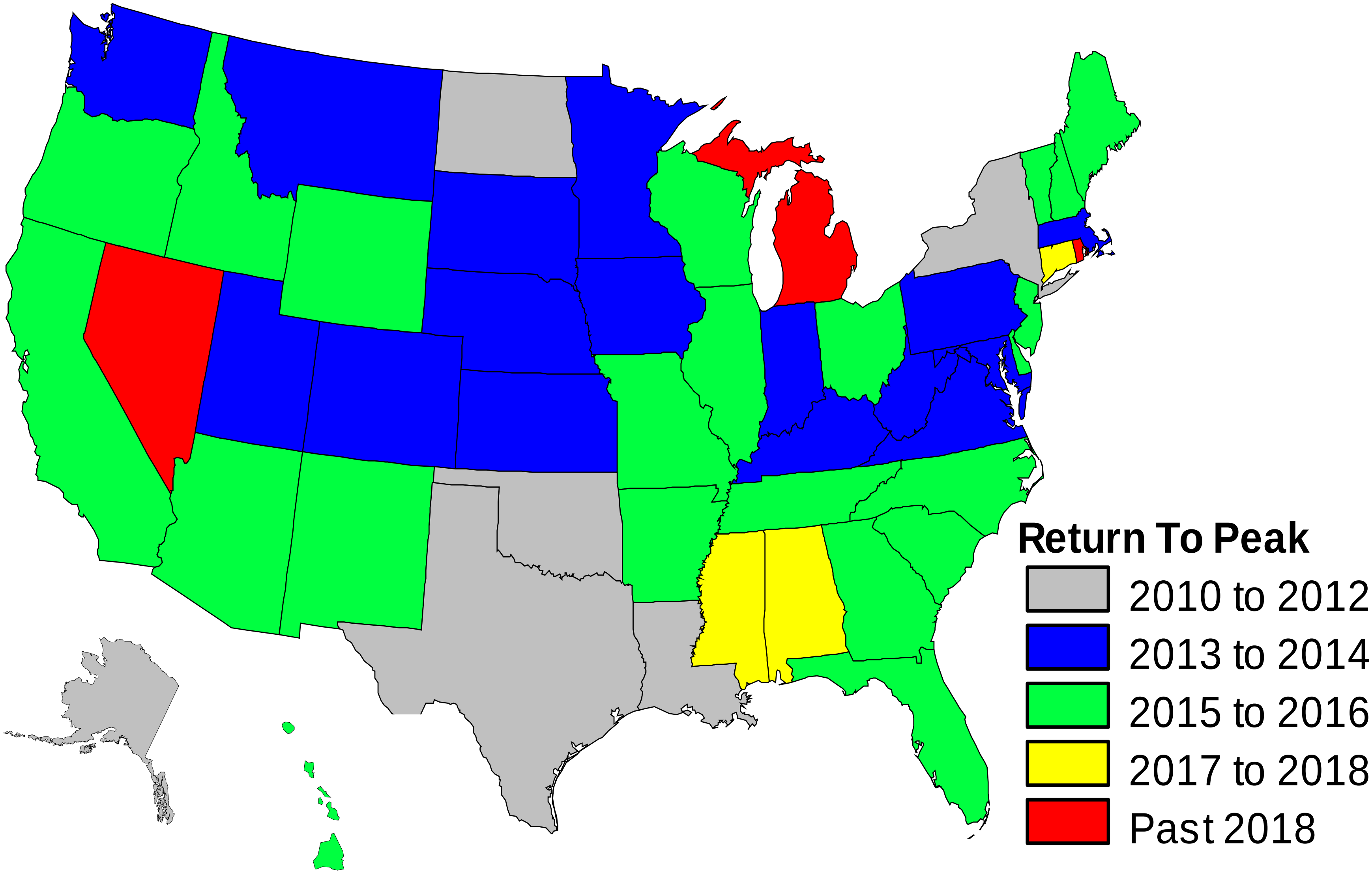
Exports 2012S1



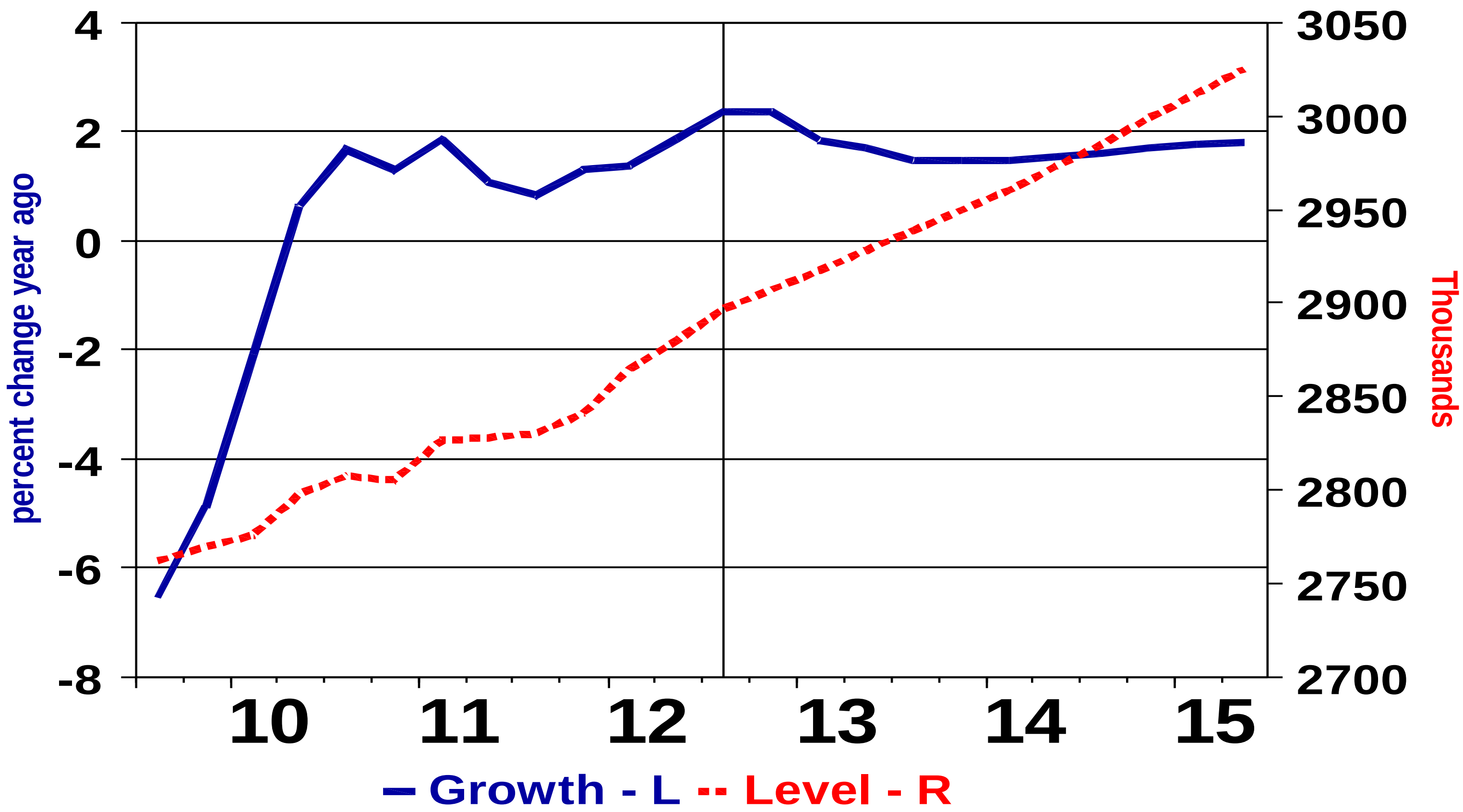
Employment Growth 2013



Return to Peak Employment

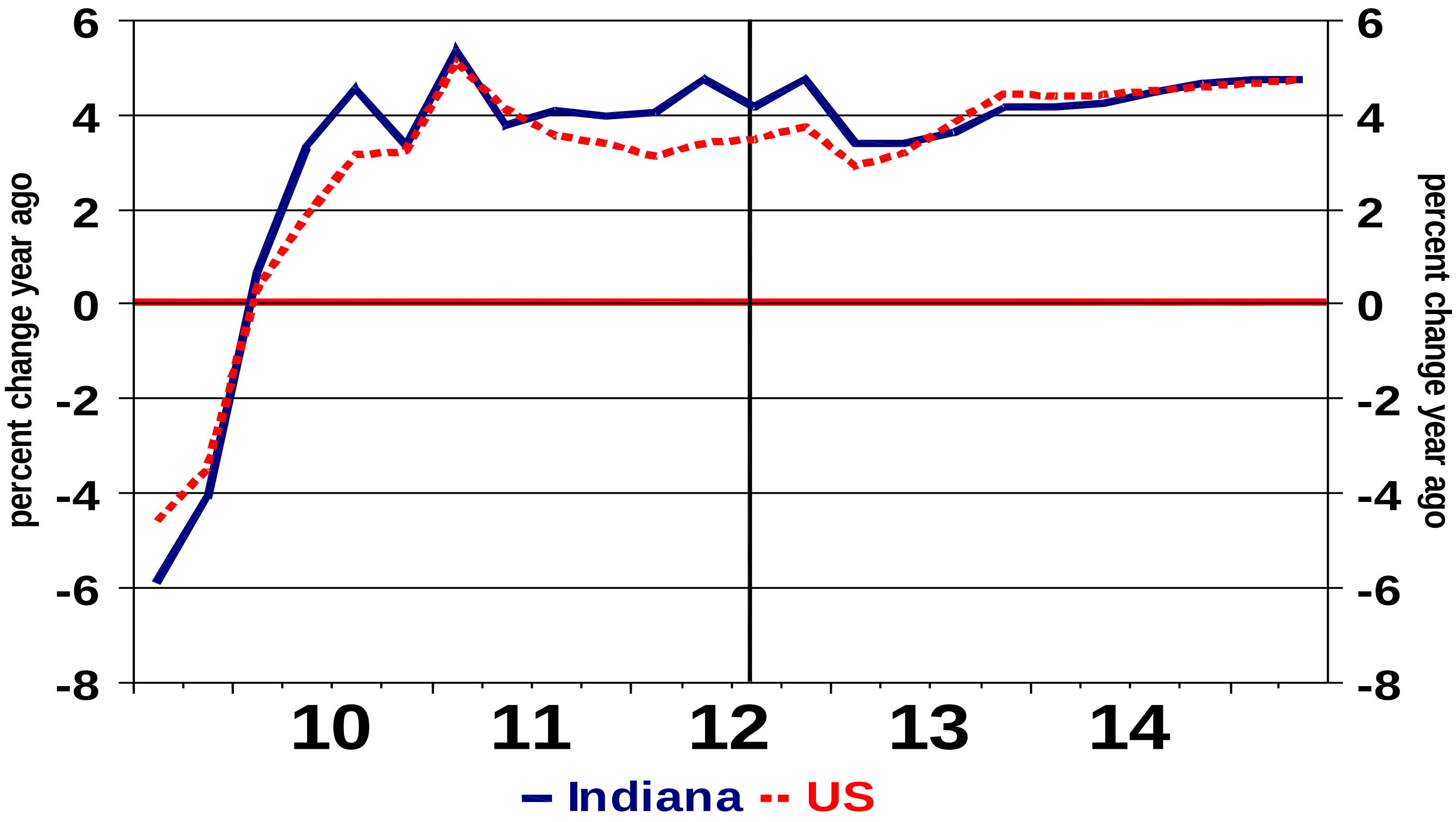


Indiana Employment Forecast

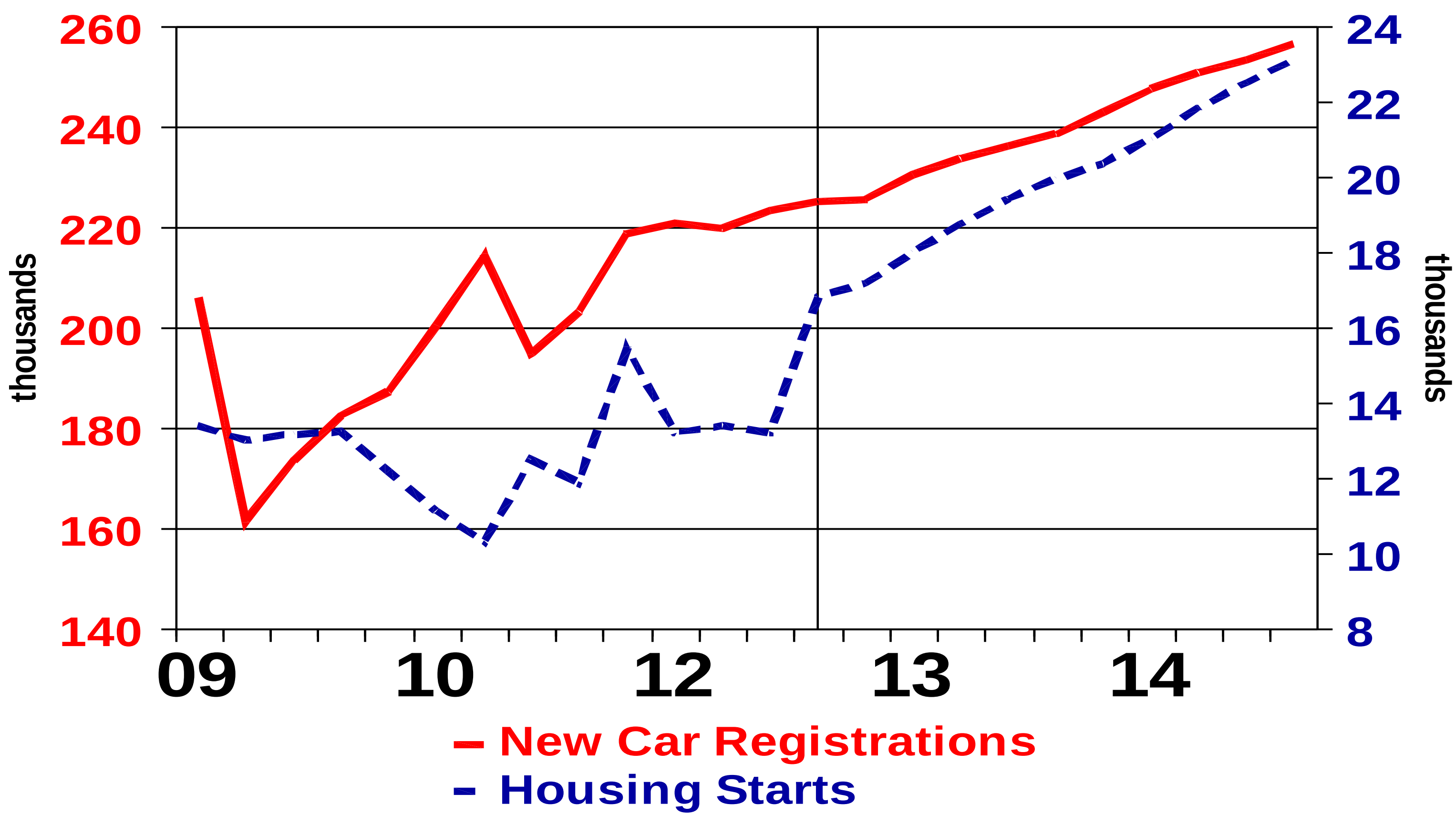


Wage Gains

(nominal total wages and salaries)



Indiana Cars and Houses



Indiana Forecast Summary

(Percent unless otherwise noted)

	2011	2012	2013	2014
Employment	1.2	2.0	1.6	1.6
Unemployment Rate	9.0	8.1	7.6	7.4
Personal Income	5.3	4.2	3.3	4.4
Housing Starts (000)	12.5	14.2	18.3	20.8
Retail Sales	8.4	5.5	2.5	2.0
Real Gross State Product	1.1	1.4	2.6	2.3

Thank you!

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